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Statement of

Robert E. McKenzie

on behalf of the

**American Bar Association
Section of Taxation**

**IRS Oversight Board Hearing
Washington, DC**

January 27, 2003

Panel 3: Effective Collection Strategies

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on behalf of the
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Good afternoon. My name is Robert E. McKenzie. I practice tax law in Chicago, and currently serve as the Division Coordinator for the American Bar Association Section of Taxation to the IRS Wage and Investment Division. This testimony is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the policy of the Association.

I. Introduction

The Section of Taxation is comprised of more than 20,000 tax lawyers. As the country's largest and broadest-based professional organization of tax lawyers, one of our primary goals is to make the tax system fairer, simpler and easier to administer. Our members include attorneys who work in law firms, corporations and other business entities, government, non-profit organizations, academia, accounting firms and other multidisciplinary organizations. We advise on virtually every substantive and procedural area of the tax laws, and interface regularly with the Internal Revenue Service ("IRS") and other government agencies and offices responsible for administering and enforcing such laws. Many of our members have served in staff and executive-level positions at the IRS, the Treasury Department, the Tax Division of the Department of Justice, and the congressional taxwriting committees.

We very much appreciate the opportunity to provide input to the Board regarding ways in which the IRS might more efficiently and effectively administer the internal revenue laws. There are, of course, numerous aspects to this enormous task. My testimony today focuses on what we believe to be an especially important administrative objective: effective collection of federal income taxes. In that regard I will focus my comments principally on the offer in compromise program and how it has been implemented. I will also address briefly a number of other issues affecting tax collection.

II. Offers in Compromise

Section 7122 of the Internal Revenue Code grants the IRS the authority to compromise tax obligations. The offer-in-compromise (“OIC”) program is intended to bring taxpayers, who are sincerely trying to fulfill their obligations, back into compliance. In order to accomplish this objective more effectively Congress and the Treasury Department have gradually liberalized the OIC program in recent years – both by expanding the grounds on which compromise may be granted and by establishing allowable expense guidelines that permit taxpayers entering into compromises to provide for basic living expenses in light of their particular facts and circumstances. Notwithstanding Congressional and Treasury initiatives, we as tax practitioners have found that in practice the statutory and regulatory objectives of the OIC program are not being met. In fact, the effectiveness of the OIC program is being severely undermined in certain cases by the manner in which it is being implemented.

Traditionally, compromise was permitted on two grounds: doubt as to collectibility (*i.e.*, the taxpayer conceded the amount due, but was unable to pay it) or doubt as to liability (*i.e.*, the taxpayer contended that he or she did not owe the underlying liability and was able to show that the issue had not adequately been heard earlier in the administrative process). In 1998, Congress

expanded the scope of the program by directing the IRS to implement a third ground for compromise: "effective tax administration."

While the aim of the OIC program is to collect the maximum, reasonably collectable amount from the taxpayer, while still encouraging future compliance --both in terms of filing returns and paying tax -- the IRS in recent years has tended to process OICs restrictively with the result that taxpayers are not only left with tax debts that they are not reasonably able to pay but also are strained to meet their current tax obligations.

How has this occurred? In the summer of 2001, the IRS created a new centralized processing system for offers in compromise. The centralized processing system was designed to reduce the backlog created by the increasing number of offers in compromise submitted each year. Unfortunately, in some cases, the backlog is being reduced simply by the return of offer packets that have only minor omissions in documentation. For example, documentation sometimes is simply lost. Lost documentation is treated the same as documentation that was never submitted. Failure by the taxpayer to provide the missing documentation in a short time-frame results in the offer not being processed at all. This strict "gatekeeper" approach is not consistent with recent congressional efforts to liberalize the OIC program and to encourage reasonable collection alternatives.

Similarly, many IRS employees below the Appeals level who process offers in compromise refuse, in direct contravention of the amendments to IRC §7122 enacted in the Restructuring and Reform Act of 1998, to consider individual facts and circumstances when applying allowable expense standards for offers in compromise. While Appeals generally observes the IRC §7122 requirements, the OIC program is not benefiting all taxpayers it is intended to reach if fair consideration of an offer can only be obtained at the Appeals level.

In addition, the IRS has taken the position that if a taxpayer can pay the tax debt, based on his current monthly income and expense extrapolated over the entire remaining statute of limitations for collection, an OIC will not be available. In fact, as a condition of approving an offer, some area offices have insisted that the statute of limitations be extended up to five additional years, both for purposes of determining the acceptable offer amount and the term for its payment. While it is obvious that some baseline period is necessary to determine collectibility, these are unrealistic measurement standards.

Finally, although compromise based upon effective tax administration ("ETA") grounds is still relatively new, and final regulations on ETA were only issued in July of 2002, the ability of taxpayers to compromise on these grounds is being frustrated by a lack of clear policies concerning the processing of ETA offers. The final ETA regulations did not provide a meaningful indication of what kinds of cases have a chance of succeeding on ETA grounds.

In the long run, the desire to collect the maximum amount of tax possible must be weighed against disincentives to future compliance that are being created by current restrictive OIC policies. To realize the objectives of the OIC program more effectively, we recommend the following:

- Return to a local system of processing offers in compromise, or streamline centralized processing by permitting offers to be submitted for initial consideration with only the amount of documentation essential to make a reasoned decision.
- Direct IRS employees who are processing offers in compromise to exercise more discretion when evaluating the sufficiency of documentation submitted with an offer.

- Assign experienced Revenue Officers to review each incoming OIC.
- Ensure that IRS employees are properly trained to follow statutory directives to consider individual facts and circumstances when applying allowable expenses.
- Support legislative and administrative efforts to develop additional guidelines on processing ETA offers.

III. Allowable Expense Standards

A. Background

In August, 1995, the IRS adopted guidelines with respect to taxpayer expenses that would be taken into account when considering installment agreements and offers in compromise. The guidelines on national and local allowances published by the IRS are designed to enable taxpayers entering into offers in compromise to settle their tax liabilities while still providing for basic living expenses.

To introduce additional flexibility into the OIC program and, in particular, “make it easier for taxpayers to enter into OIC agreements,” Congress, in 1998, directed the IRS to continue the practice of prescribing guidelines for allowable expenses. In addition, Congress expressly directed that the allowable expense guidelines be expanded to provide that IRS employees consider the facts and circumstances of each individual taxpayer before ultimately determining the appropriate amount of allowable expenses for such taxpayer. In particular, the legislative history anticipates that the IRS would “take into account factors such as equity, hardship, and public policy” in making individual determinations. Unfortunately, practice has shown that IRS employees rarely deviate from the published expense tables. Additionally, allowable expense guidelines are often administered unfairly and inconsistently.

The IRS created two categories of expenses to guide examiners in their decision-making: Necessary Expenses and Conditional Expenses. The IRS has charts for national and local standards setting forth its view of necessary living expenses. Necessary Expenses are based on national and local standards tables, which are usually less than the taxpayer's actual expenses. Conditional Expenses are those expenses that the IRS does not consider meeting the Necessary Expense test, but which it might allow if the taxpayer can pay the outstanding taxes pursuant to an installment agreement within five years. If the taxpayer could not pay within five years, one year is allowed to eliminate the Conditional Expenses.

B. Necessary Expenses

The IRS procedures provide that a Necessary Expense will be allowable if “it provide[s] for a taxpayer's and his or her family's health and welfare and/or the production of income.” The IRS requires that Necessary Expenses be in an amount that reflects the minimum on which the taxpayer and his or her family can live based on prescribed national, local or other applicable administrative standards:

1. National Standards: These provisions establish reasonable amounts standards for five types of Necessary Expenses: food, housekeeping supplies, apparel and services, and personal care products and services. The first four standards come from the Bureau of Labor Statistics ("BLS") Consumer Expenditure Survey 1999-2000. The last standard has been established by the IRS. Any amount above the national standards may be considered excessive. Alaska and Hawaii have been allowed some upward adjustment because of their high cost of living. However, the IRS adjusts Hawaii expenses upward by 10% yet its employees receive a 25% cost of living adjustment. It is also noteworthy that the same standards are applied everywhere in the continental United States despite

the fact that personal living expenses vary widely. For example, contrast the personal living expenses of a New York City resident with those of a Des Moines resident. It is clear that the New Yorker would face significantly higher costs yet the tables do not reflect any differential.

2. Local Standards: Local standards have been established for housing and transportation. The IRS has established a housing category for each county in the United States. Housing standards, which include utilities, are extremely parsimonious. However, when applying the local housing standards, the IRS employee is allowed to consider other factors that might justify an expense in excess of the local housing standard including, for example:

1. The increased cost of transportation to work and school which would result from moving to lower cost housing;
2. The tax consequences that would result from selling a home;
3. The tax consequences which would result from moving from an owned home to a rented home, and
4. The cost of moving to a new residence.¹

The tables impose particular hardships on young families because they are based upon averages and include homeowners whose homes were acquired years ago and have low mortgage payments.

Transportation standards are established for regions with additional amounts allowed for particular metropolitan areas. The IRS Tables set the standards for amounts to be

¹ Internal Revenue Manual 5.15.1.3.2.2.2

allowed for car purchase and lease, repairs, insurance, maintenance and fuel.² These amounts are inadequate. For example, in the Washington, D. C. area the IRS allows \$55 per month for a second vehicle. A family with teenage drivers would have insurance costs alone that would exceed \$55 per month.

3. Reasonableness Standards: IRS collection employees may allow other expenses if believed to be necessary and reasonable in amount. Because there are no national or locally established standards for determining reasonable amounts, the IRS employee is given discretion to determine whether an expense is necessary and the amount is reasonable.³

None of the standards provides properly for the economic needs of the average family. Taxpayers are essentially told to live below a subsistence level. Moreover, because the standards are based on data for periods a year or more before the time of negotiation, they invariably fail to reflect current average costs.

C. Conditional Expenses

Conditional Expenses, which include excessive Necessary Expenses, are taken into account if the taxpayer has the ability to pay the tax liability, including projected accruals, within five years. In addition, the taxpayer has up to one year to modify or eliminate unallowable Conditional Expenses if the tax liability, including projected accruals, cannot be fully paid within five years. By way of example, if a taxpayer's car payment exceeded the standards by \$100, that expense would have to be eliminated within one year. In practice, most taxpayers have many expenses that exceed the tables and reducing all of them is usually not possible.

² Internal Revenue Manual 5.15.1.3.2.2.

³ Internal Revenue Manual 5.15.1.3

D. Other Necessary Expenses

The IRS standards for Other Necessary Expenses are quite strict and lack flexibility.⁴

⁴ (1) In addition to those listed under the National and Local Standards, certain other expenses are usually considered to be necessary.

- (a) taxes,
- (b) health care,
- (c) court-ordered payments,
- (d) involuntary deductions,
- (e) accounting and legal fees for representing a taxpayer before the IRS,
- (f) secured or legally perfected debts (minimum payments), and
- (g) accounting and legal fees other than those for representing a taxpayer before the IRS which meet the necessary expense test of health and welfare and/or production of income.

(2) Depending upon individual circumstances, other expenses may meet the necessary expense test: health and welfare and/or production of income.

(3) A taxpayer may be required to substantiate the amounts and justify these expenses as necessary. Unless the tax liability will be fully paid, including projected accruals, within five years, expenses must be reasonable in amount. Expenses include, but are not limited to:

- (a) childcare,
- (b) dependent care: elderly, invalid, or disabled,
- (c) secured or legally perfected debts,
- (d) life insurance,
- (e) charitable contributions,
- (f) education,
- (g) disability insurance for a self-employed individual,
- (h) union dues,
- (i) professional association dues;
- (j) accounting and legal fees other than those for representing a taxpayer before the IRS which meet the necessary expense test of health and welfare and/or production of income, and
- (k) optional telephone services (call waiting, caller identification, etc.) or long distance calls, if they meet the necessary expense test of health and welfare and/or production of income.

(4) The last two listed expenses are frequently encountered: charitable contributions and education.

(a) Charitable contributions. These expenses include donations to tax exempt organizations such as civic organizations, religious organizations (tithing and educational), and medical services or associations. To be necessary, charitable contributions have to provide for a taxpayer's or his or her family's health and welfare or be a condition of employment. Otherwise, they are conditional and allowable only if the tax liability, including projected accruals, can be paid within three years.

(b) Education. To be a necessary expense, a taxpayer must demonstrate that:

1. the education is for a physically or mentally handicapped dependent and must demonstrate that such education is not otherwise provided by public schools: or

2. the education is a condition of employment. [IRM 5.15.1.3.2.3]

(5) The expenses listed in IRM 5.15.1.3 do not exhaust the category of necessary expenses. Other expenses may be considered if they meet the necessary expense test: health and welfare and/or the production of income.

E. Unsecured Debts

The taxpayer's payment of unsecured debts generally does not qualify as a Necessary Expense unless the expense is necessary for the production of income or is in settlement of a credit enforcement action. The IRS standards have forced many taxpayers to file for Chapter 13 bankruptcy protection in order to secure reasonable repayment terms.

F. Excessive Necessary and Conditional Expenses Incurred after Assessment of Tax Liability

The IRS takes the position that it will not take into account any Conditional Expense or Excessive Necessary Expense incurred after the assessment of a tax liability. IRS employees are instructed that in such instances consideration of enforcement against the post-assessment assets or not allowing the expenses in an installment agreement may be appropriate. The IRS employee has the authority, however, to make exceptions to the five-year rule⁵ and in unusual situations the IRS can choose to allow Conditional Expenses even if the liability, including projected accruals, cannot be paid within five years. In practice, very few IRS employees have seen fit to exercise this authority to vary from the five-year rule.⁶

G. Results of IRS Policies

As a result of the restrictive allowable expense standards and the inflexible application of these standards by the IRS, taxpayers are forced to make difficult decisions that undermine the effectiveness of the OIC program.

(6) If other expenses are determined to be necessary and, therefore, allowable, the case history must be documented providing the reasons for the decision.

⁵ Internal Revenue Manual 5.15.1.3.2.2

⁶ Internal Revenue Manual 5.15.1.3.3.1.4

The IRS should revisit its standards in order to have a more realistic approach to family needs. The standards for personal expenses should provide for regional variances in expenses. Taxpayers should be allowed to account for legal obligations in their budgets. IRS personnel should exhibit more flexibility in applying the standards.

In the case of offers in compromise, IRC §7122(c)(2)(B) now provides that, in applying its standards, the IRS “shall determine, on the basis of the facts and circumstances of each taxpayer, whether the use of the schedules... is appropriate and shall not use the schedules to the extent such use would result in the taxpayer not having adequate means to provide for basic living expenses.”⁷ In practice, the IRS rarely deviates from its schedules. The IRS should be directed to comply with the provisions of IRC §7122(c) and rely more extensively on the application of individual facts and circumstances. A more flexible policy in this regard would result in more successful offers in compromise and, thus, increase collection revenues.

We also propose that IRC §6159 be amended to adopt language similar to §7122(c) for installment agreements. The IRS should be required to review the facts and circumstances of each taxpayer when considering an installment agreement. The current application of the standards has caused adverse results, including forced bankruptcies, increased default rates on installment agreements and hardships to taxpayers attempting to pay their tax debts. We believe that greater IRS flexibility in this regard will increase collection rates for delinquent taxes.

⁷ IRC §7122(c) **Standards for evaluation of offers.**

(1) In general.

The Secretary shall prescribe guidelines for officers and employees of the Internal Revenue Service to determine whether an offer-in-compromise is adequate and should be accepted to resolve a dispute.

(2) Allowances for basic living expenses.

(A) In general. In prescribing guidelines under paragraph (1), the Secretary shall develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.

V. Other Problem Areas

A. Abuse of Collection Due Process by Tax Protestors

The 1998 Reform Act granted new rights to taxpayers with respect to IRS collection procedures. Specifically, taxpayers now have the right to request a hearing before levy action is taken against the taxpayer.⁸ Taxpayers are also provided with a hearing after a federal tax lien is placed on their property. These collection due process ("CDP") hearings are designed to ensure that the collection actions proposed to be taken against the taxpayer are reasonable, and that the IRS has fully complied with all statutory and procedural collection requirements.

While CDP hearings have helped to usher in a new era in IRS-taxpayer relations, and are designed to promote a higher quality of service, they have also contributed to a decline in collection expediency because (i) they have placed greater demands on decreased IRS staff, and (ii) some taxpayers have intentionally used them as tools to delay collection frivolously. Current statutory and/or administrative provisions should be amended to decrease the number of unnecessary and frivolous CDP hearings.

CDP hearings are conducted by the IRS Appeals Division. This past year, approximately 30,000 new CDP cases reached Appeals, and collection cases now account for half of Appeals' workload.⁹ Under the existing statute, the IRS must grant a CDP hearing if the taxpayer submits a timely written request for a hearing.¹⁰ This means that a taxpayer cannot be denied a hearing based on issues that he or she intends to raise — even frivolous arguments challenging the

⁸ I.R.C. §§ 6320 and 6330.

⁹ See "Bogged Down With Collection Cases, IRS Appeals Is Hot on Fast Track," 2002 TNT 211-2 (Oct. 31, 2002) (summarizing comments of IRS Appeals Chief David S. Robison made at AICPA's Fall Tax Division Meeting in Washington, D.C.).

¹⁰ I.R.C. §§ 6320 and 6330; Treas. Reg. § 301.6330-1(d).

federal government's authority to levy and collect income taxes (*i.e.*, "tax protestors"). The IRS currently instructs its Appeals employees that it is not appropriate to deny a CDP qualified taxpayer a hearing because the only issues they raise are frivolous or otherwise do not qualify for consideration.¹¹ Moreover, Appeals must grant a face-to-face hearing, even to a tax protestor, if one is requested.¹²

Because Appeals does not have any discretion to deny CDP hearings, it is forced to process tax protestor cases that serve only to frustrate IRS collection efforts and to delay other taxpayers' cases. Invariably, tax protestors seek judicial review of Appeals' determination of their case. Although courts have willingly upheld the imposition of penalties in response to such frivolous arguments, they have not been able to prevent tax protestors from misusing and bogging down the judicial process.¹³

Reducing the impact of the frivolous use of collection due process has been a strategic goal of the IRS for more than a year.¹⁴ Accordingly, the IRS and Treasury should continue to promote legislation that would provide statutory authority to deny requests for CDP hearings that are based on frivolous arguments. Legislation is currently pending which would permit the IRS to treat portions of CDP hearing requests based on frivolous positions (to be defined and listed periodically by the IRS) as never having been submitted, and would deny administrative or

¹¹ I.R.M. § 8.7.2.3.3 (11-13-2001).

¹² Treas. Reg. §§ 301.6330-1(d), Q-D7; I.R.M. § 8.7.2.3.3 (11-13-2001) (making an exception only for potentially dangerous taxpayers).

¹³ See, e.g., Pierson v. Commissioner, 115 T.C. 576 (2001); Davidson v. Commissioner, 84 TCM 156 (2002); Lemieux v. United States, 2002-2 USTC ¶ 50,220 (D.C. Nevada 2002).

¹⁴ See, e.g., JCS-2-02, Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, as Required by the Internal Revenue Service Restructuring and Reform Act of 1998, (May 8, 2001) (containing a statement by Commissioner Charles O. Rossotti that he would like the collection provisions of RRA 1998 to be changed).

judicial review of such portions.¹⁵ Additionally, this legislation would preclude a taxpayer from raising frivolous issues at a CDP hearing.¹⁶ The passage of such legislation would be a step toward ensuring that collection due process serves the purpose originally intended by the 1998 Reform Act. However, we have some concern about granting the IRS unfettered discretion to determine when a position is frivolous.

Short of legislation that denies CDP hearings based on frivolous positions, Treasury and the IRS should consider promoting legislative efforts that would amend the statute to deny further judicial or administrative review of Appeals determinations with respect to CDP hearings in which frivolous positions are advanced. Likewise, the Tax Court could be granted jurisdiction to enjoin further frivolous claims, and new criminal penalties could be enacted for application to taxpayers who have repeatedly requested CDP hearings based on frivolous positions and/or who have repeatedly advanced frivolous positions during CDP hearings. Additionally, the IRS and Treasury could support legislation to specifically deny face-to-face hearings to tax protestors. Such a provision would still allow Appeals to process these types of cases more efficiently, and it would be consistent with Appeals' practice of terminating CDP hearings in situations where a taxpayer persists in raising frivolous issues.¹⁷

Administrative measures might also be implemented in this area. For example, Treasury should consider amending the regulations to deny tax protestors the right to request an "equivalent hearing," which is a hearing that is available to taxpayers who have failed to timely request a CDP hearing.¹⁸ Equivalent hearings are not required by statute and, therefore,

¹⁵ See Tax Administration Reform Act of 2002, H.R. 5728, 107th Cong. § 307.

¹⁶ *Id.*

¹⁷ I.R.M. § 8.7.2.3.3 (11-13-2001).

¹⁸ Treas. Reg. § 301.6330-1(i).

administrative action alone may be taken to deny their availability to tax protestors. Furthermore, the IRS should develop a policy of prioritizing or fast-tracking frivolous CDP hearing requests. These claims should receive expedited consideration by Appeals and be promptly rejected using appropriate standard language.

B. Priorities on Collection: Trust Fund Taxes

The next issue is the priority being given to collection of trust fund taxes. This issue involves employers who fail to pay over to the IRS the employment taxes which they withhold from employees' wages.

This is a critical enforcement priority but, in practice, we find that enforcement is frequently tardy and relatively ineffective. Perhaps more importantly, this is an area in which the announced, and often widely publicized, refusal of certain employers to withhold and pay over these taxes encourages tax non-compliance and disrespect for the tax system.

Our system of payroll taxes serves a double function: it supports the revenue needs of our government, while simultaneously funding health and welfare benefits for broad segments of our society under the Medicare and Social Security programs. While enforcement of individual income tax liabilities will always be important, in a practical world in which competing claims for enforcement resources must be weighed and reconciled, we believe that the continued failure by the IRS to enforce payroll tax obligations aggressively is fundamentally detrimental to our tax system. In aggressively seeking to enforce employment tax obligations, however, the IRS must ensure that it carefully determines which employees may be personally liable for the penalties associated with the enforcement action.

C. Treatment of Nonfilers

Another perennial problem is nonfilers, taxpayers who simply do not file tax returns. Since 1979, the General Accounting Office has issued at least three studies, and one report to Congress, dealing with the nonfiler problem.¹⁹ The GAO studies provide the following recommendations to improve filing compliance:

- The IRS should contact delinquent taxpayers as soon as possible to get returns filed and to prevent delinquency over a number of years.
- The IRS should consider using non-audit personnel to "man the phones" to follow up with delinquent taxpayers.
- The IRS should develop a better statistical model to identify nonfiling situations and to use information obtained from various state agencies and other information sources more effectively to identify and track nonfilers.
- The IRS should allocate sufficient funds and personnel to the nonfiler issue on an on-going basis.

About a decade ago, the IRS tried a new approach to this problem by instituting its "Nonfiler Initiative," intended to get nonfilers back into compliance.²⁰ The basic feature of the program was to allow taxpayers to file delinquent returns in exchange for the assurance that no criminal prosecutions would occur. In addition, the IRS told taxpayers that people who could not pay their outstanding liabilities would be allowed to enter into installment agreements, or that

¹⁹ See "Internal Revenue Service – Results of Nonfiler Strategy and Opportunities to Improve Future Efforts," GAO/GGD-96-72 (May, 1996); "Tax Administration – Improving IRS' Business Nonfiler Program," GAO/GGD-89-39 (March, 1989); "Tax Administration – IRS Could Reduce the Number of Unproduced Business Nonfiler Investigations," GAO/GGD-88-77 (May, 1998); and "Report to the Congress – Who's Not Filing Income Tax Returns? IRS Needs Better Ways To Find Them And Collect Their Taxes," GGD-79-69 (July 11, 1979).

²⁰ See "IRS Reaches Out To Bring Nonfilers Back Into The Tax System, IR-News Rel., 1992-94 (September 30, 1992); and "IRS Says Nonfilers Who Come Forward Are Not Prosecuted," IR-News Rel., 1992-114 (December 7, 1992).

the liabilities might be reduced or eliminated under the offer-in-compromise program. The IRS was successful in obtaining the help of outside tax professionals who volunteered their time to help with the preparation of delinquent tax returns.

The Nonfiler Initiative ran from 1993 through mid-1995. The program was a success because it (1) reduced the size of the nonfiler inventory; (2) eliminated unproductive cases; and (3) increased the number of returns secured from individual nonfilers. The GAO, however, had concerns about the results of the program because (1) the IRS had not set a goal for the number of nonfilers it wanted to bring into compliance; (2) the IRS had not prepared a plan to prevent recidivism of nonfilers; and (3) the IRS had not prepared a cost-benefit analysis with respect to the results achieved.

Anecdotal evidence indicates that public perception of the program was mixed. Seriously delinquent taxpayers were brought into compliance, at least temporarily. In addition, a number of states instituted their own Nonfiler Initiative that helped increase state tax revenue. The Nonfiler Initiative, however, did not provide for a blanket waiver of either interest or penalties. As a result, a number of taxpayers decided not to enter into the program because of the significant tax bill that would clearly result.

Where are we today? In 2001, the IRS issued roughly 1.4 million notices to nonfilers,²¹ and it made assessments totaling roughly \$1.9 billion with respect to substitute returns prepared on account of nonfilers.²² In addition, the IRS has once again identified nonfilers as a significant problem. The IRS website indicates that "IRS has implemented a 'multifunctional,

²¹ See "Internal Revenue Service – 2001 Data Book" (September 30, 2001) at Table 25.

²² Id.

comprehensive effort called the National Nonfilers Strategy.' The overall goal of the strategy is to bring taxpayers back into compliance and keep them there."

To help preserve the integrity of our tax system, it is essential that the IRS undertake serious efforts to bring nonfilers into compliance. This is especially true considering that many taxpayers now believe that the IRS has become a "paper tiger," and that failure to file one's tax return will not bring serious repercussions. We strongly recommend that the Oversight Board indicate its full support for any Nonfiler Initiative that the IRS may undertake. Moreover, we fully support any legislative or administrative proposal that:

- Increases funding which directly supports the IRS' Nonfiler Strategy.
- Increases trained personnel whose sole job is to identify and work with nonfilers.
- Develops statistical models and other information sources that will help to identify and track nonfilers.
- Develops methods to track and handle repeat nonfilers.
- Expands the "substitute-for-return" program, and institutes a "refund hold" program for habitual non-filers until all returns are brought current.
- Increases use of criminal prosecution with a dynamic publicity campaign.
- Considers another voluntary "Nonfiler Initiative" that will allow abatement of penalties and/or interest before implementing enforcement measures.

D. Repeat Abusers of the System

Many repeat delinquent taxpayers create new tax debts after being allowed to repay prior obligations. The IRS uses a scoring system for field collection efforts, and we believe that more emphasis should be placed on aggressively pursuing collection from repeaters. In the case of trust fund repeat delinquencies, the IRS should place the highest priority on field contact. The

IRS Automated Collection System is ill-equipped to deal with sophisticated delinquent trust fund liabilities whereas Revenues Officers have the skills to intervene to stop new liabilities. The IRS should also consider requiring repeaters to file returns monthly, not quarterly.²³

E. Collection Outsourcing

It is our understanding that the IRS is considering the use of private vendors to assist in the collection process. We believe that this idea warrants additional study and consideration.

F. Inadequate Training of IRS Employees

Many of our members have expressed concern that collection employees are not being trained to the standards observed in prior decades. Controversies often arise merely because inadequately trained collection employees do not follow the Internal Revenue Manual. Greater resources should be dedicated to providing quality continuing professional education to IRS employees. As a related matter, we believe that the IRS should consider raising the standards for initial employment. Raising the hiring standard, over time, will raise the quality and efficiency of IRS collection efforts.

* * *

The ABA Section of Taxation hopes that the foregoing observations and suggestions are helpful to the Oversight Board in discharging its important responsibilities. The Tax Section would be happy to meet or otherwise communicate with Board members in order to further discuss these views or any other matter on which our input might be considered helpful.

²³ IRC Sec. 7512